



ACQUISITION
AND SUSTAINMENT

THE UNDER SECRETARY OF DEFENSE
3010 DEFENSE PENTAGON
WASHINGTON, DC 20301-3010

OCT 29 2019

The Honorable Charles E. Grassley
Chairman
Senate Committee on Finance
U.S. Senate
Washington, DC 20510

Dear Mr. Chairman:

Thank you for your October 7, 2019 letter regarding your committee's ongoing investigation involving contracts with TransDigm Group Inc. (TransDigm). The Department of Defense (DoD) continues to share your concerns with regard to TransDigm's business practices, and in particular the pricing strategies that TransDigm and its subsidiaries employ for DoD acquisitions of sole source commercial spare parts.

Besides requesting and receiving the voluntary reimbursement of \$16.1 million from TransDigm, in recent months the Department has taken a number of additional steps to confront TransDigm's overpricing strategies, including:

- The creation of a Cadre of Pricing Experts to facilitate the reporting of denials of cost or pricing data and identify parts and suppliers that bear watching;
- The issuance of a June 14, 2019 memorandum directing that uncertified cost or pricing data is to be requested from TransDigm and all TransDigm affiliates, unless adequate price competition exists or the prices are set by law or regulation;
- Holding meetings with industry associations to request the assistance of the industrial base in addressing TransDigm's excessive pricing practices through appropriate negotiations with its affiliates; and
- Actively investigating potential reverse engineering possibilities for sole source parts to create competitive alternatives and drive down prices for those parts (examining over 1,000 parts).

Apparently TransDigm is feeling the impacts of the Department's recent actions, as evidenced by TransDigm's submission of a Freedom of Information Act request for any internal DoD procedures and policies being employed to implement the Department's June 14, 2019 memorandum. Further, the company requested a face-to-face meeting with the Department, which was held on October 10, 2019. At this meeting, TransDigm specifically stated that going forward, its corporate policy is that TransDigm and its affiliated companies will always provide information requested in support of determinations of commerciality, and cost or pricing data in support of price reasonableness determinations. While TransDigm's stated corporate policy seems to be a good first step, the Department made it clear to TransDigm that reestablishing confidence that the Department is paying fair and reasonable prices will require a full measure of

cooperation from all of TransDigm's affiliates. Such cooperation must include fully supporting negotiated prices with current and complete cost or pricing information and discontinuing evasive techniques, such as rejections of requests for information due to commerciality claims.

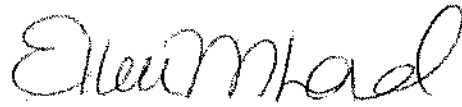
Furthermore, the Department has accepted TransDigm's suggestion to establish a collaborative effort to delve into the information requested and submitted under current and future DoD procurements. The initial focus will be TransDigm's support for the F-35 Joint Strike Fighter (JSF) platform. The Department has requested a comprehensive list of all part numbers supplied in support of both the JSF aircraft and engine, identifying the prime contract/subcontract, the TransDigm affiliated company supplying the part(s), and proposed prices and supporting cost or pricing information.

In addition to the above TransDigm specific initiatives, the Department is continuously evolving policies and regulations, and initiating projects designed to save taxpayer money. While the following initiatives are merely a small sample of the efforts the Department is currently employing, they represent magnitudes of savings greater than those potentially realized through any specific initiatives:

- Conducting peer reviews on sole source procurements under major programs to provide negotiation support and oversight, and share lessons learned and best practices across the entire Department (billions of dollars have been saved through this process);
- The creation of a dedicated team of analysts who will review, analyze, negotiate and resolve potential defective pricing instances across the Department that have been identified by the Defense Contract Audit Agency (millions of dollars in potential recoupment);
- The policy decision to require that exceptional circumstance waivers for the submission of certified cost or pricing data be held to a higher standard than the minimum requirements under statute. While the statute requires a determination be based on any of three listed conditions, the Department requires that all three conditions be determined to be applicable;
- The savings of over a billion dollars through the Department Category Management initiatives to maximize value across functional lines, saving taxpayer dollars while improving mission outcomes;
- The initiation of a contract financing study to comprehensively assess how the Department's financing policies affect the financial health of the Defense industry, and determine the level of contract financing needed to drive prompt and efficient contract performance and motivate the participation of small businesses and non-traditional Defense contractors; and
- The continued support of the Navy Price Fighter (NPF) group that provides, for example, program and overhead should cost analyses on major programs throughout DoD, resulting in a outstanding return on investment of \$96 in taxpayer savings for every \$1 spent to fund the NPF group.

Responses to your question numbers 1, 2, 4, 6, 9 and 12 are provided in the enclosure to this letter. Responses to the remaining questions are still being researched and prepared and will be forwarded in a subsequent letter no later than December 16, 2019.

Sincerely,

A handwritten signature in cursive script, appearing to read "Ellen M. Lord".

Ellen M. Lord

Enclosure:
As stated

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Question 1: Your June 6, 2019 correspondence to my office stated that the Department has \$634,718,073.64 in current contracts with TransDigm.

a. Are you concerned that TransDigm is overcharging the Department on any of these contracts, as it has done repeatedly in the past?

b. Have you ordered a review of each TransDigm contract to ensure that overpricing is not occurring within these contracts? If not, why not?

Response: The Department is concerned about these contracts. In response to congressional requests from Representatives Elijah E. Cummings, Stephen F. Lynch, Jackie Spier and Ro Khanna, the Department of Defense Inspector General (DoDIG) has initiated an audit of TransDigm Group, Inc.'s business model and its effect on DoD spare parts pricing for DoD contracts awarded between January 1, 2017 and June 30, 2019 (Project No. D2019-D000AT-0181.000). The congressional request asked the DoD IG to review TransDigm Group Inc. for potential waste, fraud, and abuse in the DoD. The DoDIG anticipates the issuance of a final audit report during the 3rd quarter of fiscal year 2020. If as anticipated, the DoDIG finds additional overcharges, the Department intends to use all legal and contractual remedies to require TransDigm to reimburse the Department and taxpayers.

Question 2: According to information obtained by my office, a TransDigm subsidiary may be overcharging the Defense Logistics Agency (DLA) by more than \$50 million through a recent contract. Has the Department conducted an assessment of this contract to ensure no price-gouging or overpricing has occurred?

Response: TransDigm has a large number of subsidiaries. Assuming this question is in regard to AeroControlex, last year, the Director of Defense Pricing, now Pricing and Contracting Initiatives requested the Air Force, in conjunction with Defense Contract Audit Agency and Defense Contract Management Agency, review prices negotiated between DLA and AeroControlex for a number of Air Force spare parts. The results of this review indicated that prices were overstated in relation to several comparison points that could add up to tens of millions of dollars over the life of the long term contract. Going forward, the Department is looking at which parts under this previous procurement can be broken out in order to increase competition with other vendors through efforts such as reverse engineering and requirements modification.

Question 4: Are there sufficient avenues for the Department to pursue money that it finds was erroneously paid out due to price-gouging schemes? If not, what does the Department believe would help recover the money that was over-charged?

Response: The Department's contracting officers have legal and contractual remedies under existing statutes and regulations to pursue inappropriate charges in relation to fraud or defective pricing. Fraud would include such actions as theft, forgery, bribery, falsification or destruction of records, and/or making false statements. Defective pricing is any contracting action subject to the Truth in Negotiations Act (TINA) where the negotiated contract price including profit or fee was increased by a significant amount because the contractor or a subcontractor at any tier furnished to the Government cost or pricing data that were not complete, accurate, and current as certified in the contractor's Certificate of Current Cost or Pricing Data. When defective pricing occurs, the Government is entitled to a price reduction to

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eliminate any significant overpricing related to the defective data. That reduction must consider increases in both cost and profit or fee related to the defective data. At this time, TransDigm does not appear to have committed actions that would constitute fraud or defective pricing (most of its contracts do not reach the statutory threshold to make them subject to TINA, or are considered commercial buys). Therefore, there are no legal or contractual remedies, outside of requests for voluntary refunds, to pursue reimbursements from TransDigm.

Question 6: Your June 6, 2019 correspondence to my office stated that the Department has concluded current laws and regulations do not prohibit a company from exploiting a position where the company owns the intellectual property (IP) and is in a sole-source relationship with the Department.

- a. If the Department believes its regulations do not prohibit this abuse, why has the Department not issued updated regulations?
- b. If the Department believes that current law is insufficient to prohibit abuse by entities, why has the Department failed to communicate these concerns to the Congress so that the Congress can address these abuses?
- c. Does the Department own, or has it ever owned, IP rights to any of the spare parts that it buys from contractors? If so, did the Department conduct lifetime cost analyses comparing manufacturing costs with purchasing costs?

Response:

- a. Adequate regulations would require new statutory authorities.
- b. In response to these TransDigm issues, the Department has initiated a legislative proposal to provide the Department with the statutory authority to obtain uncertified cost or pricing data to the extent necessary to determine price reasonableness and ensure that excessive pricing practices are curtailed. This proposal is going through internal DoD review prior to submission to Office of Management Budget for interagency review and clearance and subsequent submittal to the House and Senate Armed Services Committees for consideration in the FY2021 legislative cycle.
- c. The question whether the Department owns, or has it ever owned, IP rights to any of the spare parts that it buys from contractors does not permit a simple single answer. In the past, research programs funded by the Department often led industry efforts in technology. Today, however, technology leadership has shifted to industry, where most research and development (R&D) dollars are spent. Beginning in the 1990s, the use of performance-based acquisition strategies were encouraged and this reduced the data and IP rights requirements under contract. The Government in many instances acquired only those data and rights needed for a given acquisition. Additionally, in response to the Federal Acquisition Streamlining Act, FAR Part 12, Acquisition of Commercial Items, was created to promote commercial item buying and enhance the opportunities for attracting commercial industry to the Government marketplace. The application of FAR Part 12 works strongly against the acquisition of IP rights. And, while recent legislation has opened the aperture of commercial item determinations (such as commercial of-a-type) and allowed the Department to benefit from acquisition efficiencies, it has also enabled contractors to take advantage of reduced statutory and regulatory control, as demonstrated by TransDigm's exploitation of TINA exemptions to gain unwarranted profits. Furthermore, the use of independent research and development (IR&D) funding provides industry with additional subsidies to invest in technologies, to which the Department has absolutely no legal or contractual authority to obtain IP rights. Even if statutory revisions permitted the Department to issue revised regulations to reverse the IP and data rights policies and practices of the past

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quarter century, it is unlikely that the Department would see the full impact of such changes for decades to come when spare parts like these from TransDigm enter the sustainment phase of a program. And, while requirements for contractors to grant IP rights to the Department could partially alleviate future sole source issues, there would be other consequences to enacting such legislation, which would include disincentives for commercial and non-traditional defense contractors from doing business with the Department. That said, this month the Department has issued a new IP policy aimed at achieving a more balanced outcome on IP issues.

Question 9: Does the Department have access to Haystack? If so, does the Department provide access to contracting officers so that they may make assessments on pricing proposals on parts?

Response: Contracting shops within the Department have access to Haystack, however it is not widely used due to several known limitations. The data within Haystack does not provide a complete picture of the circumstances surrounding the purchases such as contract type and total quantity, which would influence the unit pricing, nor does it indicate actual costs of items. Furthermore, the data within Haystack is pulled mainly from DLA purchases, but only for those parts that have their own Contract Line Item Numbers (CLINs). Unfortunately, this excludes a majority of Department purchases where parts are grouped together at a higher assembly level. In other words, parts that are not procured as separate CLINs on contracts are not available in Haystack, which results in an incomplete picture. Haystack may be a useful tool in a general sense, but the data cannot be adequately relied upon to make sound price reasonableness determinations.

Question 12: In a June 14, 2019 memorandum, Acting Principal Director of Pricing and Contracting Kim Herrington instructed contracting officers to require TransDigm and its subsidiaries to submit uncertified cost or pricing data to support their pricing decisions.

- a. Has TransDigm complied with this mandatory disclosure requirement regarding uncertified cost or pricing data?
- b. What steps is the Department taking to ensure TransDigm provides the required data?

Response: In response to the Department's June 14, 2019 memorandum and actions taken to date by DoD contracting officers, TransDigm requested a face-to-face meeting with the Department (held on October 10, 2019) and submitted a Freedom of Information Act request for any internal DoD procedures and policies being employed by DoD contracting officers to request uncertified cost or pricing data to support proposed prices. The Department and TransDigm have agreed to work together to ensure all TransDigm affiliated companies are complying with the data submission requirements of the Department's memo. Through this DoD/TransDigm collaboration, and the results of the ongoing DoDIG audit, time will tell the extent to which TransDigm is complying with the data submission requirements and whether receipt of the uncertified cost or pricing data will improve price reasonableness negotiations.